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AMERICAN LEGISLATIVE EXCHANGE COUNCIL . STATE BUDGET REFORM TOOLKIT

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American Legistative Exchange Council



About the American Legislative Exchange Council

The State Budget Reform Toolkit has been published by the American Legislative Exchange Council (ALEC) as part of its mission to discuss, develop, and disseminate public policies, which expand free markets, promote economic growth, limit the size of government, and preserve individual liberty. ALEC is the nation's largest non-partisan, voluntary membership organization of state legislators, with 2,000 members across the nation. ALEC is governed by a Board of Directors of state legislators, which is advised by a Private Enterprise Board, representing major corporate and foundation sponsors. ALEC is classified by the Internal Revenue Service as a 501(c)(3) nonprofit, public policy and educational organization. Individuals, philanthropic foundations, corporations, companies, or associations are eligible to support ALEC's work through tax-deductible gifts.

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The mission of ALEC's Tax and Fiscal Policy Task Force is to explore policy solutions that reduce excessive government spending, lower the overall tax burden, enhance transparency of government operations, and promote free-market fiscal policies.

Public Sector Chairman: Indiana Sen. Jim Buck

Private Sector Chairman: Bob Williams

Task Force Director: Jonathan Williams

STATE BUDGET REFORM TOOLKIT

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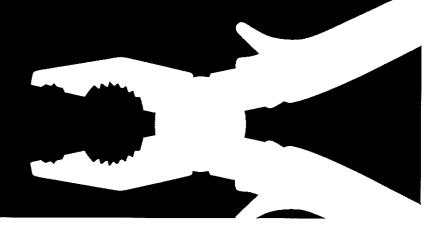
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Table of Contents

| 1. Intro | oduction | |
|----------|--|----|
| | A. Problem: The Current Budget System | v |
| | B. Solution: Priority-Based Budgeting | vi |
| II. Too | ls to Modernize State Budgeting | |
| | A. Define Core Governing Principles | |
| | B. Require Non-Partisan Revenue Forecasts and Independent Certification of Budgets | |
| | C. Pass a Strong, Balanced Budget Requirement | 1 |
| | D. Adopt an Effective State Spending Limit | 1 |
| | E. Require Preparation of Agency Mission Statements | 1 |
| | F. Adopt Performance Assessment and Management | 1 |
| | G. Budgeting for Outcomes | |
| | H. The Item-Reduction Veto | 18 |
| III. Too | ols to Improve Budget Transparency | |
| | A. Create a Transparent Budget Web site | 20 |
| | B. Adopt a 72-Hour Budget Timeout | 2 |
| | C. Require Fiscal Notes Before Action on Spending Bills | 2 |
| IV. Too | ls to Control Costs and Improve Government Efficiency | |
| | A. Adopt a State Hiring Freeze | 2 |
| | B. Reform State Pensions | |
| | C. Restructure State Retiree Health Care Plans | 24 |
| ÷ | D. Eliminate Positions Vacant More Than Six Months | 25 |
| | E. Delay Automatic Pay Increases | 26 |
| | F. Adopt Activity-Based Costing | 26 |
| | G. Adopt a Sunset Review Process for State Agencies, Boards, and Commissions | 27 |
| | H. Allow the State Auditor to Conduct Performance Audits | 28 |
| | 1. Establish a System of Independent Recovery Audits for Improper Payments of Taxpayer Funds | 28 |
| | J. Embrace the Expanded Use of Privatization and Competitive Contracting | 29 |
| | K. Establish a State Privatization and Efficiency Council | 32 |
| | L. Create a Statewide Real Property Inventory and Search the | |
| ٠. | Balance Sheet for Asset Sale and Lease Opportunities | 34 |
| | M. Achieve Savings Through Employee Incentive Programs | 37 |
| /. Conc | lusion | 38 |
| /I. App | endix | 39 |
| | Index of Recommendations | 39 |
| | Index of ALEC Model Logislation | |

I. Introduction



A LEC's State Budget Reform Toolkit will advance a set of budget and procurement best practices to guide state policymakers as they work to solve the current budget shortfalls. The toolkit will assist legislators in prioritizing and more efficiently delivering core government services through advancing Jeffersonian principles of free markets, limited government, federalism, and individual liberty.

Today, states face structural deficits created by overspending. Most of the legislative "fixes" over the past few years for state budget gaps have merely postponed or obscured the problems rather than addressing them directly.

A contributing factor to state budget gaps is the expiration of the federal stimulus funds provided by the American Recovery and Reinvestment Act (ARRA). Although these federal funds temporarily supported state budgets, the money will not last forever. When it is gone, states will be faced with gaping holes in their budgets, as policymakers in many states have imprudently opted to rely on these temporary federal funds in order to avoid making difficult, but necessary, budget reforms to align expenses with revenues.

To solve this problem, the temptation will be to use a "business-as-usual" approach: raise taxes, raid non-general fund accounts, delay funding of some legislation, avoid fully funding pensions, and use federal stimulus funds to postpone meaningful budget reforms. Some of these actions may give states a temporary "patch" in their budget shortfall, but when the federal funds expire, when pension tabs for delayed contributions come due, and when there are few off-budget accounts

left to raid, states that did not take real action to solve their budgetary shortfalls will face even greater budget defecits. Additionally, as ALEC's Rich States, Poor States publication so aptly points out, tax increases come at a very high cost: the erosion of state economic competitiveness. In the words of President John F. Kennedy: "An economy constrained by high tax rates will never produce enough revenue to balance the budget, just as it will never create enough jobs."



Problem: The Current Budget System

A budget drives all policy within a state. For this reason, debating, writing, and approving a state budget are the primary tasks legislators must accomplish. However, when budgets are built in the traditional manner of adjusting the current budget for inflation and caseload increases, legislators become "enablers" for agencies and programs that likely have fundamental design flaws or that may be providing services that are ineffective at meeting legislative goals. This type of approach focuses almost entirely on inputs (more money). Building budgets the conventional way virtually assures overspending since there is little, if any, focus on efficiency, effectiveness, or outcomes.

Legislators often find that the baseline budget is higher than the estimated revenue forecast. They then focus on a combination of cutting programs, raising taxes, or using accounting gimmicks to make general fund resources match forecasted revenue. This approach ignores the question of whether existing state programs are efficient or effective. Rarely are the questions asked, "How can existing programs be improved?" or "How can we maximize the outcome of the tax dollars that are collected?"

Solution: Priority-Based Budgeting

This State Budget Reform Toolkit is designed to help legislators address the serious financial crises in the states by changing their budgetary system from the conventional input system, which is clearly a failed policy model, to one focused on outcomes.

This new budgetary system is called priority-based budgeting. Priority-based budgeting means state officials and citizens must first determine the core functions of government. While this may seem like an elementary step, it is seldom taken before legislative appropriations are made. Gaining control of a state budget means the following questions must be answered:

- What is the role of government?
- What are the essential services government must provide to fulfill its purpose?
- How will we know if government is doing a good job?
- What should all of this cost?
- When cuts must be made, how will they be properly prioritized?

Only by carefully considering the proper role of government can legislators and governors do an effective job protecting individual rights, while providing essential services to taxpayers in an efficient, cost-effective manner. This is not an "anti-government" philosophy; rather it is ensuring that what government is supposed to do, it will do well. Furthermore, great savings can be obtained if legislators and agencies do not spend time determining how a particular function can be performed better, faster, and cheaper if it is not a core function of government.

Priority-based budgeting views all of state government—all of its agencies and functions—as a single enterprise. It evaluates new proposals in the context of all that state government does, and develops strategies for achieving priority results with an eye on all available state resources. Priority-based budgeting helps to keep a citizen-focused perspective on the budget. It assumes we can change the rules, if necessary, to maximize the results we can get

from government. This includes removing barriers standing in the way of delivering results to citizens.

Without this approach, state budgets resemble an iceberg, with decades worth of spending unseen and unexamined under the water, while the debate rages year after year over the small part that sticks up out of the water. The longer state lawmakers continue to use the cost-plus model, the more "hardwired" their deficit problems will become.

In 2003, Washington state actually implemented priority-based budgeting to close a budget deficit of \$2.4 billion without raising taxes. Had the traditional cost-plus budgeting system been used, legislators would have started with the baseline budget and focused on cutting programs or raising taxes until the general fund matched the forecasted revenue. The state's economy was recognized by both parties as too weak to withstand a tax hike. Instead, the state prioritized services and determined what the most important things to buy or deliver were for the dollars invested.

In order to face the upcoming budget crisis, states should change their conventional budget system to a priority-based budget system. Using this tool, legislators can focus on delivering effective services to taxpayers instead of funding costly, ineffective programs. The first tool set below describes steps for states to follow to modernize their budgeting system fully.

Table 1.

Conventional Budget System: Input-Focused Priority-Based Budget System: Output-Focused

Baseline Budget

Inflation

+
Caseloads
+
Initiative Requirements
+
Additional Policy Changes
=
Business-as-Usual Budget

Core Functions of Government

+
Performance Measurement
+
Prioritized Spending Adjustments
=
Priority-Based Budget

II. Tools to Modernize State Budgeting

S tates need innovative strategies to modernize their budgeting system. The first section of our State Budget Reform Toolkit gives state policymakers a step-by-step process to implement priority-based budgeting. Tools in this section include: defining core governing principles, requiring independent certification of the budget, and passing a strong balanced budget requirement. Additional tools in this section also include: adopting an effective state spending limit, requiring agencies to prepare mission statements, adopting performance management, and budgeting for outcomes.

A.

Define Core Governing Principles

A first step in reforming state budgets is to determine the core functions of state government. Every state constitution, which lawmakers swear to uphold, contains language that cannot be ignored when building a framework for fleshing out core government functions.

When deciding the core functions of government, the following questions should be asked:

- Is this a proper function of government, or is it best left to the individual (family) or charitable organization?
- If intervention is necessary, is it best left to local government which is closer to the people?
- Does it further increase taxes, regulations, or the size of government? If so, is this justified?

Many lawmakers are unwilling to determine the core functions of government because:

- It is hard work and may take years to get right.
- Fierce philosophical battles must be waged with the end result being a compromise that may please no one.

Still, the ultimate responsibility of lawmakers is to look taxpayers in the eye and honestly report to them that government is functioning excellently within its boundaries and its means. Starting the governing process with sound core principles is a necessity. However, developing a meaningful set of core governing principles requires time and courage. Many officials will publicly embrace the notion of developing budgets around a model of more carefully prioritized spending, but most will also vigorously oppose or undermine that model in day-to-day operations.

Some legislators may disagree with the already-defined core functions, or may disagree with the newly drafted core functions. While absolute consensus is not likely, legislators should use the core functions as a starting place to develop the legislative agenda. This would result in healthy debates about the state's core responsibilities.

In some states, the legislature may not wish to wait for its governor to develop a list of core functions. In other states, it will be a joint endeavor between political parties and the branches of government. A bipartisan ratification of agreed-upon core functions should be sought within the first few weeks of budget-writing sessions. This would dramatically increase the productivity of standing committee hearings because everyone would know the terms and the budget limitations. Once the core functions for

the state have been developed, they will serve as a litmus test for the hundreds of currently funded agencies, boards, commissions, and programs. Agencies should be asked to submit their budgets based on delivering one or more of the state's identified core functions.

Washington's core functions are detailed at: www.ofm.wa.gov/budget/pog/default.asp

In Washington state, this approach considered revenue for all sources (not just the general fund) and assumed no spending commitments were sacrosanct. The legislature chose which spending to add to the budget in order to deliver the core functions and prioritized activities within those functions.

Recommendation: All existing programs should fit within one of the core functions or they should be abolished. Measurable outcomes for each core function should be identified and agency activities prioritized.



 The Evergreen Freedom Foundation, The Stewardship Project, Olympia, WA, June 2003. www.effwa. org/pdfs/stewardship2003.pdf

Require Non-Partisan Revenue Forecasts and Independent Certification of Budgets

The current budgeting process allows far too much room for discretion in revenue projections, creating the opportunity for unrealistic projections to serve as the foundation for state spending. Two interrelated reforms can help to address this problem: (1) have a non-partisan revenue forecast council that meets quarterly and publishes an official state revenue forecast, and (2) have an independent, third-party certification of the budget.

Using non-partisan revenue forecasts—which should account for all taxes, fees, and charges by state government—can help eliminate the bureaucratic tendency to rely on higher-end revenue estimates just to balance the budget. However, states should go further by undertaking the second reform. Requiring the state treasurer (or a

similar comptroller or state auditor) to certify the budget would help to ensure that the budget relies on realistic revenue forecasts. Further, this approach creates a political incentive for accurate budgeting since the treasurer's professional credibility (and potential political future) is on the line.

The Texas Constitution gives the comptroller in that state the authority to certify the state's budget. In advance of each regular legislative session, the comptroller prepares and submits to the governor and legislature a statement, under oath, showing the financial condition of the state treasury at the close of the last fiscal period and an estimate of the probable receipts and disbursements for the current fiscal year. The statement also contains an itemized estimate of the anticipated revenue based on the laws then in effect from all sources, showing the fund accounts to be credited during the succeeding biennium.

"Using non-partisan revenue forecasts can help eliminate the bureaucratic tendency to rely on higher-end revenue estimates just to balance the budget."

Except in the case of emergency or imperative necessity and with a four-fifths vote in each house, no appropriation is considered valid if it exceeds the cash and anticipated revenue of the funds from which such appropriation is to be made. No bill containing an appropriation can be considered as passed or be sent to the governor for consideration until and unless the comptroller certifies that the amount appropriated is within the amount estimated to be available in the affected funds.

Recommendation: State policymakers should close the current gap in their budgeting process by adopting provisions similar to Texas. Giving the state's chief financial officer the ability to prevent unrealistic budgets from being adopted until the budgets match expected reve-

nues would be an important step towards tightening and strengthening fiscal control systems to keep the price of government in check.



Additional Resources:

- State of Texas, Senate Research Center, Budget
 101: A Guide to the State Budget Process in Texas,
 Austin, TX, January 2005. www.senate.state.tx.us/
 SRC/pdf/Budget101_2005.pdf
- Texas State Constitution, Article 3, Sec. 49a, Financial Statement and Estimate by Comptroller of Public Accounts; Limitation of Appropriations. www.statutes.legis.state.tx.us/Docs/CN/htm/CN.3.htm



ALEC Model Legislation:

- · Balanced Budget Certification Act
- Independent Revenue Forecasting Act



Pass a Strong, Balanced Budget Requirement

One major flaw in state spending is that the legislature, which is responsible for drafting state spending, rarely produces a balanced budget. While most states do have balanced budget requirements, all too often state legislators also take advantage of accounting maneuvers that push expenses into future budgets, for example issuing specious and unsustainable bond programs.

The balanced budget requirement needs to be carefully structured to include all funds so legislators don't use accounting gimmicks to push the operating deficit into future budgets. Ideally, legislators should adopt the "98-2-60" approach. This means the state should spend no more than 98 percent of forecasted revenue on previously identified priorities of government, put 2 percent away in reserves and require a 60 percent supermajority to change the 98 percent-2 percent rule.

The primary benefit of this policy recommendation is that it would allow states to "stop the bleeding." There are many budgetary repercussions that will take time to solve. First and foremost, incumbent officials must be able to guarantee to voters that reckless spending is a thing of the past.

Recommendation: Pass a balanced budget requirement, mandating that the expenditures included in the budget for the next fiscal year shall not exceed estimated revenues, and create a protected emergency reserve account.



Additional Resources:

 Washington Policy Center, Citizens Guide to SJR 8206, Budget Stabilization Account, Olympia, WA, September 2007. www.washingtonpolicy.org/ publications/notes/citizens-guide-sjr-8206-budgetstabilization-account



Adopt an Effective State Spending Limit

Many states have attempted to curtail spending (or, more accurately, spending growth) with mixed success. In fact, a majority of states maintain some sort of spending limit or rainy day fund, but their effectiveness varies greatly.

"First and foremost, incumbent officials must be able to guarantee to voters that reckless spending is a thing of the past."

The importance of using both a spending limit and a rainy day fund is to help smooth out expenditures over the business cycle and avoid the dangerous boom-and-bust cycle of budgeting. The purpose of the spending limit is to provide the fiscal discipline necessary during strong periods of revenue growth, to not overextend the budget, and to avoid creating a structural deficit caused by overspending. This two-pronged policy would make state budgets more resilient in the face of unanticipated expenses. The inaccessibility of the emergency funds would mandate bipartisan effort to solve problems instead of relying on tenuous party-line votes.

When properly designed and implemented, Tax and Expenditure Limits (TELs) have proven to be effective in constraining the growth of government spending, and stabilizing government budgets over the business cycle. ALEC's model legislation incorporates features that make TELs effective and successful:

- Incorporate TELs into state constitutions, rather than in easily evaded or ignored statutes.
- Use TELs to limit the rate of growth of revenue and/or expenditures to the sum of inflation plus population growth.
- Do not link TELs to some measure of aggregate economic activity, such as personal income. This type of limit is less effective in constraining the growth of spending and stabilizing the budget.
- Apply TELs to a broad measure of revenue and/or expenditure, exempting only federally funded expenditures.
- Use TELs to provide for the disposition of surplus revenue above the TEL limit.
 - A portion of surplus revenue should be placed in an emergency reserve fund. Use of this emergency reserve fund should be limited to natural disasters, as opposed to revenue shortfalls.
 - With an emergency reserve fund in place, a portion of surplus revenue should be allocated to a budget stabilization fund. The budget stabilization fund should only be used to offset revenue shortfalls in periods of recession.
- A portion of the surplus revenue should be allocated to tax cuts or tax rebates to constrain the growth of spending. Tax cuts and tax rebates reveal to taxpayers the opportunity cost of allowing government to spend the surplus revenue.
- The most effective TELs require voter approval to increase taxes, issue debt, or spend surplus revenue.

When taxpayer approval is required on ballot measures, taxpayers-not elected officials-will determine how much government spending they want and are willing to pay for.

Recommendations: States should adopt a constitutional revenue or spending limit. Such a limit would impose much needed discipline on profligate spending patterns.

Additional Resources:

- Poulson, Barry W., Colorado's Taxpayer Bill of Rights (TABOR) Amendment: An Experiment in Direct Democracy, Americans for Prosperity Foundation, Washington, DC, 2009. www.voteontaxes. com/images/Colorado_s_taxpayer_bill_of_rights tabor_an_experiement_in_direct_democracy.doc
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- Segal, Geoffrey F. and Adam B. Summers, The Sky Isn't Falling: Proven Strategies for Budget Reconciliation, Americans for Prosperity Foundation and Reason Foundation, Washington, D.C., October 2005. www.reason.org/files/d54cdb9ddc42ffbfd6dffd894005e25c.pdf
- Laffer, Arthur, Stephen Moore, and Jonathan Williams, Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index, American Legislative Exchange Council, Washington, D.C., 2010. www.alec.org/AM/PDF/tax/10RSPS/RSPS2010-Final.pdf

ALEC Model Legislation:

Tax and Expenditure Limitation Act



Require Preparation of **Agency Mission Statements**

Unbelievably, only half of the states require their agencies to develop mission statements. Many problems arise when agencies do not have clear goals and objectives. Requiring agencies to prepare mission statements—with goals and objectives that link back directly to core functions of governments—would help solve the business-as-usual budgeting problem. Agency mission statements describe the agency's reason for existing in general terms that capture its unique purpose and functions.

Agency goals should be broad, high-level, issue-oriented statements of an organization's desired future direction or the outcomes that they strive to achieve. Goals elaborate on the organization's mission statement, articulating the overall expectations and intentions for the agency. They should fit well with the mission statement and answer the question: What do we need to achieve to carry out our mission? Objectives break down the goals into smaller, more specific outcome-oriented pieces. They describe the measurable results an agency is expected to accomplish within a given time period.

"The benefits of this recommendation are clear: with well-defined roles, local and state government can work in concert to provide services."

The benefits of this recommendation are clear: with well-defined roles, local and state government can work in concert to provide services. "Red tape" and burdensome, overlapping of roles can be eliminated. Taxpayers benefit in understanding exactly which agencies to go to for services. The agencies themselves benefit because they avoid being forced to assume additional responsibilities when other agencies face budget cuts, or are eliminated entirely. Lastly, policymakers benefit because it will be clear to see exactly which agencies require an increase (or decrease) in funding.

Recommendation: The legislature should require each agency to have a mission statement with goals and objectives linked to the state's core functions of government.



Adopt Performance Assessment and Management

Once the budget is built, policymakers and administrators should compare those expenditures against the expected performance outcomes, using the lessons learned to make necessary adjustments to build the next budget. All agencies should have clear performance indicators so that policymakers and voters can easily monitor their efficiency. If there is no performance monitoring, several problems may arise.

Legislators face a Samaritan's dilemma in that failing agencies receive increases in funding despite being poorly run, when properly run agencies that are under duress should receive additional funding. Conversely, agencies may be facing a decreased workload, but receive the same amount (or even additional) funding when a reduction of funding is pertinent.

Agencies should have at least one performance outcome measure for each major activity in their activity inventory—if not, the activity should be eliminated. An effective activity performance measure:

- Indicates whether the activity is achieving its purpose or is contributing to statewide results. Immediate and intermediate outcomes are preferable, although in some cases, output and efficiency measures help tell the story.
- Is reliable, accurate, and verifiable.
- Is understandable and relevant to citizens and stakeholders who may have little or no knowledge of agency operations.
- Is stated in positive terms (or in terms of the desired outcomes).
- Is connected to challenging, yet achievable, targets.
- Can be obtained at reasonable cost and for reasonable effort.

To help improve budget accountability, high-level performance outcome measures should be placed directly in the budget. By doing so, state officials and citizens can quickly determine whether performance goals have been met, evaluate the effectiveness of activities purchased

in the budget, and gauge whether the investment has proven its worth versus the cost (see discussion under Section II.G: Budgeting for Outcomes).

Many governments have taken steps to require agencies to start monitoring their performance, but this concept can be taken much further by instituting a process to regularly review all state programs for performance, relevance, and efficiency. While the benefits of performance measurement may seem obvious, merely measuring agency and program performance is insufficient by itself. Without a corresponding mechanism for oversight—a process designed to ensure performance on an ongoing basis across all agencies—nothing will change.

In this process, each agency should be required to regularly demonstrate how each activity it performs directly relates to achieving its core mission. This process can identify immediate opportunities for streamlining, consolidation, and alternative delivery. Ultimately, the process should integrate into the larger budgeting process, fully funding performing and effective programs, while reducing or eliminating funding to ineffective, redundant, or poorly performing programs. The review should include, but not be limited to, making recommendations for elimination or alternative delivery systems.

The Bush administration developed a robust process model at the federal level that can serve as a template. The Office of Management and Budget (OMB) developed the Program Assessment Rating Tool (PART) in 2002 to evaluate programs based on their purpose, strategic design, management, and results. OMB takes these assessments into account while reviewing agency budget requests, and the results are reported in the President's budget submission to Congress. Between 2002 and 2008, the administration evaluated the performance of over 1,000 programs constituting 96 percent of all federal programs. During that time, program ratings increased across the board, and programs whose results could not be demonstrated due to a lack of relevant information declined from a whopping 50 percent to 19 percent.

Congress has been slow to use PART information to make budget allocation decisions, and the administration has

enjoyed only limited success in convincing the legislature to eliminate or reduce funding for poorly performing programs. However, over the life of PART, high performing programs have generally received larger funding increases than those that did not perform well.

"Traditionally, state budgeting focuses only on the increase to a base budget, and rarely are the 'big picture' questions asked—in essence, the budget is on 'autopilot."

Indiana Governor Mitch Daniels has adopted a similar process in Indiana, launching an aggressive review of the size, scope, functions, and budget of each agency, dubbed PROBE (Program Results: an Outcome Based Evaluation). PROBE reviews each state program to justify its work and demonstrate results, and is conceptually similar to the federal PART analysis established under Daniels' leadership as federal OMB director. The findings of the first PROBE reports revealed that over half of the 420 state programs examined did not have measures that sufficiently reported on the performance of the program. Following the publication of the PROBE report, agencies were requested to develop appropriate program measures, which will feed into a larger performance-based budgeting process within Governor Daniels' Office of Management and Budget.

Recommendation: After requiring that all agencies create a traceable monitor of their performance, a separate process should be instituted at the enterprise level to regularly assess their performance.

Additional Resources:

 Pew Center on the States, Policy Framework to Strengthen Government Planning, Budgeting, and Accountability, Government Performance Project, Washington, D.C., March 2010. www.pewcenteronthestates.org/report detail.aspx?id=57708

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- Government Management Accountability and Performance, Publicly Measuring Performance, State of Washington, November 2010. www.accountability.wa.gov/default.asp



- · Council on Efficient Government Act
- An Act Relating to Performance Audits of Governmental Entities



Budgeting for Outcomes

The adoption of a priority or outcome-based budgeting system would help state policymakers to more easily identify the governmental activities most important to citizens, as well as to make difficult trade-off and cost-benefit decisions more easily. It would also result in the provision of better, more efficient state government services, while protecting taxpayers and maintaining fiscal responsibility.

Surely, state governments can stop providing some functions, but unfortunately, the traditional budgeting process fails to facilitate this sort of downsizing. Traditionally, state budgeting focuses only on the increase to a base budget, and rarely are the "big picture" questions asked—in essence, the budget is on "autopilot." The logic of autopilot budgeting is simple—in order to maintain current service levels, agencies need to spend what

they did last year plus an increase to account for inflation and population increases. Put simply, this moves the discussion to the margins of spending—the annual spending increase requests from agencies. Unfortunately, the other 90 to 95 percent of spending is left out of the debate and is seldom analyzed for relative merits. In fact, it is generally assumed that the activities should continue to receive funding. The traditional budgeting process effectively establishes a default position that state government will just continue to expand over time, representing an unsustainable approach to state fiscal management.



Several states (and also cities and counties) are changing their views about government budgeting. Priority or outcome-based spending treats spending as an investment—the type and amount of investment should change yearly as revenue, results, performance, and needs change. Budgeting this way shifts the focus on the investments and what can be accomplished with available resources—when resources run out, spending stops. Using this model, deficits are nearly impossible.

States need to follow the lead of Washington state, lowa, and others (see Table 2 on the following page) and begin shifting to an outcome-based budgeting system—also known as Budgeting for Outcomes (BFO)—in which policymakers and the public collaboratively rank programs. It helps leaders rank programs according to how costeffective they are at achieving the results citizens want. The state government then goes down the list, funding the most important programs first, "buying down" with available revenues until it runs out of money. This ensures that vital services are being funded before less-critical ones, and services not deemed of the highest import are reduced or eliminated. Kitchen table budgeting works this way, and there's no reason the state shouldn't do the same.

Table 2.

Jurisdictions That Have Used Budgeting for Outcomes

States Counties Washington Snohomish, WA lowa Multnomah, OR South Carolina Mesa County, CO Michigan Polk County, FL Louisiana Dept. of Culture, Recreation, and Larimer County, CO Tourism Coconino County, AZ Cities School Districts Azusa, CA Jefferson County, CO Spokane, WA Billings, MT Dallas, TX Ft. Collins, CO Northglenn, CO Redmond, WA Eugene, OR Savannah, GA Baltimore, MD Source: David Osborne, The Next California Budget: Buying Tacoma Metro Parks, WA Results Citizens Want at a Price They Are Willing to Pay, Policy Study 380, Reason Foundation, April 2010, p.2.

Washington State—Priorities of Government Budgeting Model

Budgeting for Outcomes was first employed by Governor Gary Locke in Washington state in 2002 and was called the Priorities of Government (POG) model. At the time, Washington faced a potential \$2.4 billion budget shortfall (approximately 10-15 percent of the size of the general fund operating budget). Significant changes were needed to plug the hole in the budget. In an effort to make the most of limited resources and ensure that the most important governmental functions were properly funded, the Locke administration called for a top-to-bottom evaluation of what services the government provides and how.

The Public Strategies Group, led by reform expert David Osborne, developed the POG approach with the Locke administration as a central means of closing the budget deficit. The administration identified a set of ten key results that citizens expect from government:

- Improve student achievement in elementary, middle, and high schools.
- Improve the quality and productivity of our workforce.
- Improve the value of postsecondary learning.
- · Improve the health of Washington citizens.
- Improve the security of Washington's vulnerable children and adults.
- Improve the economic vitality of business and individuals.

- Improve statewide mobility of people, goods, information, and energy.
- Improve the safety of people and property.
- Improve the quality of Washington's natural resources.
- Improve cultural and recreational opportunities throughout the state.

Result teams were formed to analyze government activities in each of the ten result areas. In Washington, result teams were comprised of six to eight subject-matter experts from state agencies, and were led by the Office of Financial Management. These teams analyzed and ranked government activities according to how well they achieved the desired outcomes as outlined in the ten governmental goals. The result teams were aided by a 10-member "guidance team" comprised of leaders of the public, private, and nonprofit sectors. The guidance team was tasked with overseeing the prioritization process and reviewing the work of the result teams.

In order to aid in the decision-making process, result teams were each given a dollar allocation to serve as an upper spending limit for their purchase plans. Washington reached several key conclusions regarding the allocation limit:

- The prioritization process is often more meaningful when the allocation is less than the amount currently spent in that area.
- A dollar constraint encourages creativity, keeps proposals grounded in financial reality, and forces people to articulate priorities and choices.

The priority rankings established by the result teams were then used to develop the 2003-05 biennial executive budget proposal. Activities were funded from the top of the list down until the spending limit was reached. Figure 1 offers an illustrative example of some of the spending priorities that were established.

Washington state still uses the POG model under the current administration, demonstrating the longevity of the approach and its resilience to changes in leadership.

Figure 1. Washington State POG Example Purchased: \$24 Billion Billon K-12 education for S10 25 1,000,000 students \$2.7b Higher education for 215,000 students \$3.7b Health care for 979,000 children & needy people \$3.8b Protecting vulnerable children, adults and families \$1.4b Public safety, including prison for 15,500 \$125m Economic development Natural resources and parks \$310m \$133m Legislature \$82m 100 013 5369m Government operations SLED Dept service on capital projects \$55m Pension contributions \$344m Reserves (General Fund = \$214m, Health Services = \$78m, Emergency Reserve Fund = \$67m) Reductions: \$2.4 Billion

UNFUNDED PRIORITIE

\$2.4 Billion

| \$109m | Lower costs in higher education |
|--------|---|
| \$221m | Future class size reduction |
| \$112m | K-12 programs beyond basic education |
| \$187m | Lower-priority programs for vulnerable children and adults |
| \$389m | Future expansion of Basic Health Plan |
| \$277m | Health coverage for 68,000 adults now on Basic Health Plan |
| \$774m | Pay increases/benefits for state- funded employees, pensions savings |
| \$112m | Consolidation and staff reductions of 2,600 FTE |
| 260 | |

Source: Washington State Office of Financial Management

2. Why Budgeting for Outcomes Works

Across-the-board cuts are generally ill-advised—they treat and affect the highest performing and most important services equally with the lowest performing and least important services. By focusing on performance and priorities, policymakers can target their cuts—ridding taxpayers of poor performing, non-essential, and non-core services.

Since politicians, special interests, and bureaucrats often focus on narrow interests and spending priorities, ignoring the larger picture and the sacrifices necessary to accommodate those desires—perhaps the greatest benefit of the Budgeting for Outcomes (BFO) approach—is simply making budgetary priority and trade-off decisions clear to all. As a 2005 U.S. Government Accountability Office (GAO) report of innovative state performance budgeting efforts noted:

One Washington legislator said that [BFO] provided decision makers with proposed priorities in a clear and easily understood format that encouraged constructive debate. . . Legislative officials said that the greatest contribution of [BFO] was that it provides a strong, clear means of communicating budgetary trade-offs to both decision makers and the public.

The BFO approach to budgeting has several other advantages over the traditional incremental "line-item" approach:

- Focuses on achieving results and developing statewide strategies for realizing goals, instead of focusing narrowly on agency "silos."
- Illustrates not only which programs are cut, but which programs are funded.
- Presents trade-offs and cost-benefit decisions in a way that is clear and easy for decision makers and citizens alike to understand.
- Makes performance information more relevant and useful to budget decisions.
- Allows decision makers to reward programs and activities that best serve state goals and helps

- reduce waste by identifying ineffective and duplicative programs and services.
- Helps identify statutory limitations that obstruct more effective service delivery.

Recommendation: States should adopt a BFO approach to bring sanity and fiscal sustainability to the state budget process. BFO integrates strategic planning, zero-based budgeting, and performance-based budgeting into a workable, common-sense system that has been replicated in numerous state and local governments. State policymakers would be well-advised to begin implementing a similar transformation in their budgeting process to ensure that taxpayer dollars are spent with maximum effectiveness and that the trade-offs among different categories of spending—especially in a budget crisis—are made clear and explicit.

Additional Resources:

- Osborne, David, The Next California Budget: Buying Results Citizens Want at a Price They Are Willing to Pay, Reason Foundation, Los Angeles, CA, April 2010. www.reason.org/files/california_budget_david_osborne.pdf
- Osborne, David and Peter Hutchinson, The Price of Government: Getting the Results We Need in an Age of Permanent Fiscal Crisis, Basic Books, New York, NY, 2004. www.psg.us/reinvention/pogbforeinvent.html
- Office of Financial Management, Priorities of Government homepage, Washington State, Olympia,
 WA, November 2010. www.ofm.wa.gov/budget/pog/
- U.S. Government Accountability Office, Performance Budgeting: States' Experiences Can Inform Federal Efforts, Report No. GAO-05-215, p. 14, Washington, D.C., February 2005. www.gao.gov/new.items/d05215.pdf
- Evergreen Freedom Foundation, Next step in priority-based budgeting, Olympia, WA, November 18, 2003. www.effwa.org/main/article.php?article_id=240&number=51

There is a widespread belief in the public sector—and among many policymakers—that as the state population increases and incomes rise, government spending should increase at a roughly equivalent rate. This assumption reveals a key difference between private sector managers and government managers. While it is true that the burden on state government grows as the population increases and the economy fluctuates, it is also vital that policymakers learn from the private sector, and continually work to reduce taxes and regulations through innovative and entrepreneurial government reform.

In the private sector, the cost of producing a product continually reduces over time because competition encourages companies to increase efficiency in their delivery of services. As a result, costs go down and consumers get better value for their tax dollars. The following tools will give legislators valuable ideas to control costs and improve government efficiency.



The Item-Reduction Veto

From 1950 to 2009, U.S. state and local government spending grew 33 percent faster than the private sector. More recently, from 2000 to 2009 state and local spending growth outpaced the private sector by nearly 90 percent. This is not sustainable. State and local governments depend entirely on the private sector for their resources and cannot continually outpace the wealth-creating sector of the economy. State policymakers looking for ways to limit government spending have a number of options. One potent and little-discussed means of limiting spending is the "item-reduction veto."

Like the president, every governor in the nation possesses the power to veto pieces of legislation. Unlike the president, however, governors in all but four states possess a line-item veto, allowing them to reject certain sections of bills without striking the entire piece of legislation. In just twelve states, however, the governor possesses an even more-potent veto power: the item-reduction veto.

The item-reduction veto is similar to the line-item veto but it permits the governor a further power: It allows him or her to reduce the amount budgeted for a particular item without striking the item altogether (it does not, however, allow a governor to increase the amount). The power gives governors superior agenda-setting authority. More importantly, it has been an effective tool to combat excessive spending.

"More recently, from 2000 to 2009, state and local spending growth outpaced the private sector by nearly 90 percent. This is not sustainable."

Using observations from 47 states over a period of nearly 30 years, economist Mark Crain compared the potency of various institutions that can affect state spending. After controlling for various demographic factors, Crain examined the impact of the item-reduction veto. Among all institutional controls on spending, the item-reduction veto stood out. Its ability to limit per capita spending is nearly five times as great as that of the other institutions.

State and local spending has been growing at an unsustainable pace for decades. According to the GAO, "state and local governments' long-term fiscal position will steadily decline through 2060 absent policy changes." One policy change that might help states avert fiscal crisis is a line-item reduction veto.

Recommendation: Adopt an item-reduction veto policy.



Additional Resources:

 Crain, Mark, Volatile States: Institutions, Policy, and the Performance of American State Economies, Ann Arbor, MI: University of Michigan Press,

- 2003. www.press.umich.edu/pdf/0472113038-fm. pdf
- Crain, Mark and James C. Miller III., Budget Process and Spending Growth., William and Mary Law
 Review 31, no. 4, pages 1021-46, Williamsburg,
 VA, 1990. http://scholarship.law.wm.edu/cgi/
 viewcontent.cgi?article=1983&context=wmlr
- Government Accountability Office, State and Local Governments: Fiscal Pressures Could Have Implications for Future Delivery of Intergovernmental Programs," Washington, D.C., 2010, www.gao.gov/ new.items/d10899.pdf
- Mitchell, Matthew, State Spending Restraint: An Analysis of the Path Not Taken, Mercatus Center at George Mason University Working Paper, no. 48, Arlington, VA., August 2010. www.mercatus.org/ publication/state-spending-restraint
- New, Michae, Proposition 13 and State Budget Limitations: Past Successes and Future Options, Cato Institute, Washington, D.C., 2003. www.cato. org/pubs/briefs/bp83.pdf



(L) ALEC Model Legislation

Item-Reduction Veto Constitutional Amendment

III. Tools to Improve Budget Transparency

"We might hope to see the finances of the Union as clear and intelligible as a merchant's books, so that every member of Congress and every man of any mind in the Union should be able to comprehend them, to investigate abuses, and consequently, to control them."

- Thomas Jefferson



Create a Transparent Budget Web site

At some point most citizens wonder, "Just how, when, and where does government spend our tax dollars? What do our elected representatives want to accomplish when they spend public money, and what results are actually achieved?"

Considering state lawmakers will spend billions each budget cycle, these are basic questions to which any tax-payer should be able to get answers quickly and conveniently. This is especially true since modern technology makes accessing large amounts of information easier than ever.

Since adopting model language to promote budget transparency in 2007, ALEC has witnessed dozens of states pass comprehensive legislation to improve transparency and accountability by establishing central, searchable databases of government expenditures. These Web sites have streamlined the process of budget research, reduced the burden of paperwork on state agencies, and generated millions of hits, demonstrating real public interest in such an effort.

The purpose of ALEC's model "Taxpayer Transparency Act" is to provide a searchable budget Web site to show

citizens where their tax dollars are spent and for what purpose. Among the types of information typically included on such sites are:

- · State expenditures by fund or account.
- · Expenditures by agency, program, and subprogram.
- · State revenues by source.
- State expenditures by budget object and sub-object.
- State agency workloads, caseloads, and performance measurements.
- Historical information on state spending as well as access to state service contracts.

States can easily implement transparent budget Web sites at minimal cost. The state of Nebraska placed its expenditures online for \$37,000, down from a previous \$1.3 million price tag. Oklahoma implemented budget transparency at minimal cost to taxpayers. According to the sponsor of the legislation, the software to build the Web site only cost \$8,000. The cost of such Web sites is minimal, and almost always overstated. Inflated cost estimates occur for a few reasons, most commonly, a lack of information and a desire to kill the project as it threatens "business-as-usual."

Transparent budget Web sites are also an asset to policymakers and agencies because they identify and eliminate waste and inefficiencies in their expenditures. For example, Texas Comptroller Susan Combs identified \$8.6 million in savings as a direct result of the implementation of Open Book Texas, a database similar to the one called for in ALEC's Taxpayer Transparency Act. Streamlining government and eliminating wasteful spending is much easier when financial data is provided in a convenient and useable format.

It is important for taxpayers to have detailed information about how their money is spent. ALEC's model Taxpayer Transparency Act codifies this fundamental right, making the data searchable and easily available to any taxpayer with an Internet connection. This means that the site allows users to download data from the site, and sort the figures as they see fit, free of cost. It is imperative to allow taxpayers to quickly and easily navigate a massive amount of complex expenditure and revenue data. The move towards transparency in governance is inevitable, and the sooner states decide to embrace it, the better off they will be.

Public School District Transparency

Not only do education budgets constitute a massive annual expenditure for all states, but they also play an important role in shaping the next generation of Americans. Parents, voters, and taxpayers have a vested interest in specific information about how public dollars are spent educating the state's children. ALEC's model Public School Financial Transparency Act mandates that all school districts put their expenditures and revenues online in a searchable database available free of charge, increasing accountability in the state's education funding system. This represents a massive jump forward for transparency and accountability, as sorting electronic data is infinitely more user-friendly than sorting through thousands of pages of budget documents.

The bill also contains specific privacy protections with respect to what data is allowed to be displayed on the site. The site is to contain data that is already publicly available under the state's freedom of information laws. It simply makes that information easier to obtain, streamlining the process for parents and taxpayers without any violations of privacy. By empowering officials to identify

cost efficiencies, students can get more bang for their parents' buck, ushering in a new era of accountability in education budgets.

Recommendation: States should develop searchable online budget transparency tools for state and local budgets.



Additional Resources:

- The Sutherland Institute, Transparency in Government, Salt Lake City, UT, 2008. www.sutherlandinstitute.org/uploads/transparencyingovernment.pdf
- www.kansasopengov.org
- · www.fiscalaccountability.org
- www.SunshineReview.com
- www.buckeyeinstitute.org



(A) ALEC Model Legislation:

- Taxpayer Transparency Act
- **Public School Financial Transparency Act**
- Transparency and Government Accountability Act



Adopt a 72-Hour Budget **Timeout**

A detailed review of budget priorities, by parties other than just the budget-writers, improves the transparency and accountability of state government, and may also improve the quality of proposed legislation.

To help facilitate public involvement, legislators should adopt a 72-hour timeout period once a tax or spending bill is introduced or amended, and before hearings or legislative votes occur.

Consider the fact that a state's combined budget (operating, capital, and transportation) can be hundreds of pages long. Despite the length and complexity of these documents, hearings are usually held the same day the budget is introduced, and the bill is amended and enacted with inadequate time for meaningful public input. Allowing an opportunity for a detailed review by the public prior to hearings or votes on budget bills would help increase public trust in government and enhance accountability for the spending decisions being made.

This would allow lawmakers and the public at least a three-day period to review and calmly consider the proposed budget, new taxes, or new spending before hearings or final voting occurs.

Too often, state government has approved wasteful spending as big spenders exploit its opaqueness. By ensuring proper consideration of legislation before passage, it helps to increase the public trust in government and enhances the respect for the legislature by ensuring that its operation is conducted with the openness, order, and dignity befitting the state. This "good government" bill nudges the state in the right direction by fostering public participation in the legislative process and allows the opportunity for detailed review by interested parties. Citizens deserve legislators who have the time for a detailed review prior to hearings or votes on legislation.

"Far too often, state government has approved wasteful spending as big spenders exploit its opaqueness."

The bills should be made publicly available, meaning that the bills will be posted on the legislature's Web site and published in a bill report, committee report, and/ or conference report. The 72-hour time period excludes Saturdays, Sundays, and holidays, except when the legislature is in session on such a day. Amendments offered to the bills will not be considered unless they are made publicly available 24 hours prior to any vote (excluding Saturdays, Sundays, and holidays). Because of a built-in exemption for "emergency" legislation, there is no credible argument against the "72-Hour Budget Timeout." If a lawmaker wants to appropriate public funds, those footing the cost have every right to a detailed, deliberative review by their elected officials.

Recommendation: Legislators should adopt a 72hour timeout period for all future budget and tax bills.



Gunn, Amber, Evergreen Freedom Foundation, Olympia, WA, Lawmakers Need a 72 Hour Budget Timeout, January 2009. www.effwa.org/main/ article.php?article_id=2644



(2) ALEC Model Legislation:

The 72-Hour Budget Review Act



Require Fiscal Notes Before Action on Spending Bills

Fiscal notes provide value for legislators and the public by forecasting revenue changes in proposed legislation However, many times bills are introduced and voted on before the data on fiscal repercussions are made available to those voting on the bills. State officials can easily feign surprise at the state of the budget when it is obvious that the long-term budget forecasts have either been unseen or utterly disregarded.

State officials and the public should know the full impact of a spending proposal before any action is taken. Bills proposing increased spending should not receive hearings or votes until a completed fiscal note is available.

The purpose of this recommendation is clear—profligate spending bills cannot be pushed through legislative bodies without the full fiscal consequences being made known to legislators. This is in line with several other recommendations that in totality demand more accountability from officials on both sides of the aisle.

Washington state is moving toward required fiscal notes. For the time being, fiscal notes only have to be created when requested and they are not always prepared by the time a hearing or vote is held. This gradually evolving access to the fiscal impact of legislative action is unprecedented and commendable.

Recommendation: Require completed fiscal notes before bills can be acted on.



ALEC Model Legislation:

Fiscal Note Act

Tools to Control Cost and Improve Government Efficiency

Adopt a State Hiring Freeze

During a budget crisis, all state agencies will argue their services are essential. These cries will become even louder if layoffs are discussed. Unions and other special interests will line up against layoffs and cry loudly against disrupting the status quo. This can be avoided by implementing a hiring freeze and analyzing which needs are the most pressing.

Adopting a flexible freeze on state hiring would reduce state employment growth while allowing agency managers to maintain existing staffing levels—prioritizing new hiring where it is most needed, while ensuring the overall size of state government doesn't grow. This approach maintains the flexibility necessary for agency managers to focus on the most important programs and maintain adequate service levels.

During a temporary freeze, the state should conduct an audit assessing the need for the budgeted positions. States should consider freezing all positions, not just those unfilled today. These are "vacancy savings," in other words, jobs have gone unfilled. There have been no layoffs. An exception to this could be if a department offers to layoff existing employees to be replaced by new hires that are less costly. Substituting higher cost labor for lower cost labor could save agencies money and have minimal impact on their ability to provide services.

In 2008, the Thomas Jefferson Institute and Reason Foundation found that simply not filling more than 7,600 non-critical positions (i.e., not public-safety, university faculty, and management-related positions) budgeted, but unfilled, at the beginning of 2008 would save the Commonwealth of Virginia over \$500 million a yearor more than \$1 billion during the two-year budget.

Former Arizona Governor Janet Napolitano took a similar action in February 2008, freezing all state positions except those directly involved in public health and safety or collecting and investing state revenues. At that time, the workforce affected by the freeze numbered 38,954 fulltime employees. By that September, Gov. Napolitano's office reported that the hiring freeze had resulted in a 5.3 percent reduction in the number of jobs covered by the freeze, and a reduction of the overall state workforce of 2.8 percent.

Recommendation: Adopt a state hiring freeze encompassing all departments.



(12) ALEC Model Legislation

Commission on Economy and Productivity in State Government Act



Reform State Pensions

In recent years, state governments have encountered a funding crisis in their pension plans for public employees. This crisis in the states has resulted from many factors, including:

- Escalation in health care costs
- Significant losses in the stock market
- · Costly pension and health benefits provided in defined-benefit plans
- Public employees retiring earlier and living longer

· Reduction and postponement of employer contributions to the pension plans

Many state pension plans are fundamentally flawed. Using more realistic assumptions regarding the rate of return on assets, as well as assumptions regarding the actuarial value of liabilities, it is highly unlikely that these plans will achieve actuarial balance over the amortization period. In fiscal year 2008, the states had a 1 trillion dollar gap in funding their pension plans. Furthermore, pension systems are likely to experience significant funding shortfalls in future years, even if the economy recovers and financial markets stabilize. These funding shortfalls will impose a heavy burden on future generations.

Recommendations to reform state pensions include capping off the existing pension system and forming a defined-contribution system for all new employees. State policymakers can also consider capping off pension ballooning in state employees' final years of service. Additionally, policymakers can also require increased employee contributions, limit retiree and rehire costs, and raise the retirement age for new employees. Utah also provides an excellent case study in successful state pension reform.

Recommendation: Everything should be on the table, including changes in benefits and increased employee contribution rates, as well as employer contribution rates. Most importantly, states should consider replacing their defined-benefit plans with defined-contribution (401(k) style) plans for new employees.

Additional Resources:

- Poulson, Barry and Arthur Hall, State Pension Funds Fall Off a Cliff, American Legislative Exchange Council, Washington D.C., January, 2010. www.alec.org/AM/Template.cfm?Section=State Pension_Funds_Fall_Off_a_Cliff&Template=/CM/ ContentDisplay.cfm&ContentID=12363
- Unfunded Teacher Pension Plans: It's Worse Than You Think, The Foundation for Educational Choice. Indianapolis, IN, April 13, 2010. www.edchoice. org/Research/Reports/Underfunded-Teacher-Pension-Plans--It-s-Worse-Than-You-Think.aspx

· California Pensions Underfunded by 500 Billion, Stanford University, Stanford, CA, April 11, 2010. www.sierrasun.com/article/20100411/NEWS/100 419995/1066&ParentProfile=1051



(2) ALEC Model Legislation:

 ALEC's Statement of Principles on State and Local Government Pension and Other Post Employment Benefit (OPEB) Plans



Restructure State Retiree **Health Care Plans**

Current state retiree health care plans are also fiscally unsustainable. Recent estimates suggest that the states have \$558 billion in unfunded retiree health care liabilities for current and future benefits, according to the Center for State and Local Government Excellence. As of fiscal year 2008, the Pew Center on the States reports that states had only funded \$32 billion, or 5 percent, of the total cost funded for retiree health care liabilities.

"Current state retiree health care plans are also fiscally unsustainable."

State and local government Other Post Employment Benefit (OPEB) plans for public employees are generally in worse shape than their pension plans. Most governments continue to fund these OPEB plans on a pay-asyou-go basis. To meet Governmental Accounting Standards Board (GASB) accounting standards, governments must now show the unfunded pension plan liabilities as debt in their financial statements. For OPEB plans, liabilities only need to be recognized in a footnote. Governments must also meet the 30-year time frame for eliminating unfunded liabilities in pension plans, though not in OPEB plans. Few state and local jurisdictions are meeting the 30-year amortization standard for either pension or OPEB plans. Many of these state governments would have to double their actual contribution rates to well over 20 percent of salaries to meet this standard.

It is likely that unfunded liabilities in state and local government pension and OPEB plans are over \$2 trillion. Tax-payers are no longer willing to bear the increasing cost of these plans in the form of higher employer contribution rates or decreased government services. They are demanding reforms that will bring these plans into line with pension and OPEB benefits offered in the private sector.

States may no longer be able fulfill their health care promises to retirees unless the system is restructured. Typically, states fund state employee retiree health care plans by paying current retirees' medical expenses as they occur. States that offer generous health care benefits may struggle to afford the massive price tag in the near future.

Unlike pension reform, state lawmakers have a greater opportunity to successfully restructure retiree health care benefits. Recommendations to reform state retiree health care plans include examining what percentage of the state's public employees are eligible to retire within the next five years. Other recommendations for reform include increasing employee contributions to health care plans, improving governance and oversight, lowering health care benefits, and increasing the retirement age. State lawmakers can also follow the reforms that Idaho and Indiana recently made, using these successes as their guide to a more sustainable retiree health care model.

Recommendation: Freeze defined-benefit OPEB plans, and replace them with defined-contribution plans for new employees. One approach is to offer optional participation in Health Savings Accounts (HSA) for state workers. Indiana's experience has been highly successful, with 70 percent of state workers choosing the HSA plans—with Indiana's taxpayers saving millions in the process.

Additional Resources:

- Promises With A Price, Pew Center on the States, Washington, D.C., April 30, 2008. www.pewcenteronthestates.org/uploadedfiles/Promises%20 with%20a%20Price.pdf
- At a Crossroads: The Financing and Future of Health Benefits for State and Local Government Retirees, Center for State and Local Government Excellence, Washington, D.C.,

- July 2009. www.slge.org/index.asp?Type=B_ BASIC&SEC={3A23B0F5-96FC-40AE-91D1-0DE488D5F17E}&DE={9CED9932-83D5-4183-B5F3-16C59BA66A12}
- State and Local Government Retiree Health Benefits—Liabilities Are Largely Unfunded, but Some Governments Are Taking Action, GAO, Washington, D.C., November 2009. www.gao.gov/new.items/d1061.pdf
- Poulson, Barry and Arthur Hall, Public Employee
 'Other Post Employment Benefit' Plans, The
 American Legislative Exchange Council, Washington, D.C., January 2011. www.alec.org



ALEC Model Legislation

 ALEC's Statement of Principles on State and Local Government Pension and Other Post Employment Benefit (OPEB) Plans



Eliminate Positions Vacant More Than Six Months

State public employment levels are measured using a number of different methods. One measure, typically used by agency managers when requesting budget increases, is the number of positions for an agency to meet its desired staffing level. In many cases, this measurement includes positions that have been vacant for a long time. Typically, hundreds of unfilled positions in state government exist on paper.

If a position remains open for more than six months, it is reasonable to assume the agency can do its work without an employee in that position. By eliminating all positions that have gone unfilled for six months, the state can cut budgeted payroll in areas not critical to public safety or the basic operation of state government.

This recommendation will bring more accurate budget information and lower personnel costs for providing services for the taxpayers.

Recommendation: Create a tracking system whereby any position that is vacant for more than six months is eliminated.



 Commission on Economy and Productivity in State Government Act



During an economic downturn, many people in the private sector face a reduction in pay or the loss of their jobs, while government workers are assured employment with regular raises and generous vacation, health, and retirement benefits. This is an unsustainable personnel policy that virtually ensures steady, annual spending increases.

In times of deficit, policymakers should delay automatic pay increases for state employees until the state achieves fiscal sustainability. This decision will certainly be unpopular with the public officials that are having their pay increases delayed. However, during a time of financial insolvency, private sector employees don't get the benefit of automatic pay increases either. If the legislature wants to avoid this problem, it must carefully monitor the budget to prevent this emergency step from occurring.

The budgetary benefits of this decision are clear. However, attentive voters will notice other benefits. By opting to delay the automatic pay increases, policymakers show that both the public sector and the private sector take the budget crisis seriously. It also shows that public sector employees are held accountable and don't brazenly plunder the public purse.

Recommendation: Policymakers should delay automatic pay increases for state employees until the rising costs of government are brought under control.



Commission on Economy and Productivity in State
 Government Act



Adopt Activity-Based Costing

Agency managers consistently face difficult decisions about the best way to administer state services. Of-

ten managers simply do not have access to the information they need to make important decisions—such as whether to provide a service in-house or through a contractor, or whether the cost of a service outweighs the benefits. Put simply, the question, "How many state employees does it take to change a light bulb, and at what cost?" often cannot be accurately answered in government bureaucracies because they are not set up to answer it.

The true cost of any activity in government is difficult, if not impossible, to accurately measure because agency budgets typically do not capture the full costs of conducting that activity. For example, some of an agency's overhead costs may be covered by a separate general services agency (e.g., printing, energy, information technology, payroll, human resources, etc.).

Activity-based costing is a method of cost analysis designed to describe all the cost elements of a certain activity, not just the major factors like labor, fringe benefits, supplies, and depreciation. In the private sector, activity-based costing accounts for every hour of work and each piece of equipment involved in a project, including capital, facility, and overhead costs for an organization, allowing managers to make informed decisions about the use of scarce resources.

Activity-based costing is not a novel, untested concept. It has proven effective in cities and states across the nation, saving money time and time again without forcing legislators to compromise on the quality of service they provide for their constituents.

In 1992, Indianapolis Mayor Steven Goldsmith implemented activity-based costing in agencies throughout the city. Using the new analysis tool, city workers reduced the cost of plowing snow from \$117 per mile to \$38 per mile and cut the cost of sealing cracks along the highway from \$1,200 per lane-mile to \$737 per lane-mile.

In another example, activity-based costing helped the lowa Department of Transportation generate \$200,000 in new revenue in 1996 and reduced the time needed to paint stripes on state highways. By developing a compre-

hensive cost analysis of three major activities—center line and no-passing marks; edge-line markings; and curb, island, and miscellaneous markings—the Department reduced unproductive down-time and began performing work for other governments during the time they saved.

Recommendation: Lawmakers can improve the performance of state agencies by implementing activity-based costing.



Adopt a Sunset Review Process for State Agencies, Boards, and Commissions

Once created, government agencies or programs are rarely reevaluated to see if circumstances—or agency performance itself—justify their continued existence. Naturally, this promotes government "sprawl" and spiraling public sector costs. In the absence of any mechanism to continually prune away at government, it is typically far more difficult to shut down an agency or program than it is to create it in the first place.

"Put simply, the question, 'How many state employees does it take to change a light bulb, and at what cost?' often cannot be accurately answered in government bureaucracies because they are not set up to answer it."

Luckily such mechanisms exist, one of the more powerful being the use of a "sunset review commission." Texas offers a powerful example of what a functional, effective sunset commission can achieve. The Texas Legislature established a 12-member Sunset Advisory Commission in 1977 to conduct regular assessments of more than 150 state agencies to determine: (a) if each agency is still needed, and (b) identify and eliminate waste, duplication, and inefficiency in state government.

The fiscal impact of Commission's recommendations over time has increased government efficiency. Since the sunset process began in 1978, 58 state agencies have been abolished and another 12 agencies have been consolidated. Based on reviews conducted between 1982 and 2009, the Commission estimates a potential 27-year revenue savings of approximately \$783.7 million through the sunset process, compared with expenditures of \$28.6 million for the Commission. Hence, for every dollar spent on the sunset process, Texas taxpayers have received \$27 in return.

Each sunset review must include a recommendation to either abolish or continue the agency, and it may include additional recommendations for policy changes, efficiency improvements, and the like. Notably, the Texas Legislature has approved a large majority of the recommendations of the Sunset Commission over time. If the Commission recommends continuation of an agency, the Commission must provide draft legislation to the legislature to continue for up to 12 years and correct other problems identified during the sunset review.

Under the Texas system, an agency is automatically abolished unless the legislature passes a continuation bill. If an agency is abolished, the state's Sunset Act provides for a one-year "wind-down" period to conclude its operations and transfer all property and records to an appropriate state agency.

Other states should create a similar, permanent sunset review commission to recommend ways the state can cut costs, reduce waste, and improve efficiency and service levels. This commission should review 20 percent of state programs each year, assess the importance of each agency's functions, and recommend the elimination or consolidation of unneeded or outdated programs.

Not only could a sunset review commission identify duplicative services and programs that have outlived their purpose, it could also help the legislature identify low-priority programs that the state may wish to fund during the luxury of good economic times, but that are not imperative—and therefore not justified—in times of fiscal malaise. With many states facing current budget deficits

and ongoing fiscal challenges in a sluggish economy, legislators and the governor should take this opportunity to implement a strong sunset review process to reevaluate the government's core functions and streamline the state budget.

Recommendation: States should create a permanent sunset review commission to recommend ways the state can cut costs, reduce waste, and improve efficiency and service levels.



Additional Resources:

- Texas Sunset Advisory Commission, Austin, TX, 21010. www.sunset.state.tx.us/
- Guide to the Sunset Process, Texas Sunset Advisory Commission, Austin, TX, December 2009. www. sunset.state.tx.us/guide.pdf



ALEC Model Legislation:

· Legislative Budget Audit Commission Act



Allow the State Auditor to **Conduct Performance Audits**

In many states, legislative audit committees conduct a limited number of performance audits; however, they typically audit only specific programs as directed by the legislature, significantly restricting its effectiveness. Audit assignments also face conflicts of interest because committee staff must scrutinize programs that legislators initially approved and wish to continue to fund.

Performance audits are a proven way to save taxpayer money. Performance audits consider the economy, efficiency, and effectiveness of the program or agency being audited as opposed to the normal financial compliance audits.

The state auditor should have the discretion to conduct comprehensive performance audits on a routine basis to identify waste and overlapping regulations, and ensure that taxpayers are getting the best value.

In Colorado, performance audits completed in June 2000 identified over \$12 million in savings from easily adopted policies, and \$41 million in additional, nearterm efficiency improvements. In Florida, an audit of the budget system helped the legislature and the governor enact changes that will significantly improve efficiency. In Texas, performance audits over an eight-year period identified total savings of \$8.1 billion.

Recommendation: The state auditor (or similar position) should be given the authority to conduct regular, comprehensive performance audits of state agencies.



Additional Resources:

- Performance Audit Essentials, Evergreen Freedom Foundation, Olympia, WA, January 20, 2003. www.effwa.org/main/article.php?article_ id=260&number=51
- Performance reviews (audits) top DLC priority, Evergreen Freedom Foundation, Olympia, WA, August 4, 2004. www.effwa.org/main/article. php?article_id=524&number=51



ALEC Model Legislation:

An Act Relating to Performance Audits of Governmental Entities



Establish a System of **Independent Recovery Audits** for Improper Payments of Taxpayer Funds

A contingency-based recovery audit is a powerful management tool that helps control costs and reduce looming deficits by finding and recovering misspent public funds. The recovery audit typically analyzes the past three years of expenditures. Contingency-based recovery audits produce a positive, no-risk outcome for taxpayers, since the work is performed on a contingency basis with no upfront cost to the government, or need for an appropriation.

An independent recovery audit reviews all account payables in order to identify improper payments and submits those claims to the government for its approval and collection. Once claims are approved, the recovery audit firm helps the client collect the improper payments due.

Private sector retailers initiated the contingency recovery audit process in the 1960s to improve internal controls over the payables process. With the advent of computerization, the process spread to a great many private-sector firms. Especially in times of budget shortfalls, state and local governments would be wise to initiate recovery audits or develop legislation to require such audits.

"States have been losing large amounts of money every year through improper payments.

These are dollars that will never be returned to the state treasury unless action is taken."

A state opting to initiate a recovery audit is committing to fixing a long-term budget problem. States have been losing large amounts of money every year through improper payments. These are dollars that will never be returned to the state treasury unless action is taken. Dollars lost more than three years ago are gone forever, but by acting quickly, the state can recoup improper payments and hopefully set in place corrective actions designed to reduce the future recurrence of such losses. A GAO report indicates an improper payment rate of 2.9 percent to 3.9 percent on all federal spending. Centers for Medicare & Medicaid Services (CMS) started testing recovery audits for Medicare in 2006. Six states participated in these audits with findings totaling \$900 million. An independent recovery audit will indentify those payments and help collect the funds, thus helping the budget process in the short-run.

Recommendation: States should give authority to independent firms to conduct regular, comprehensive recovery audits of state agencies.



 An Act Relating To Recovery Audits For Government Overpayments Of Tax Dollars



Embrace the Expanded Use of Privatization and Competitive Contracting

"It is better for the public to procure at the market whatever the market can supply; because there it is by competition kept up in its quality, and reduced to its minimum price."

-Thomas Jefferson, 1808

Though there are many causes of states' current fiscal woes, one contributing factor is that governments at all levels have expanded into hundreds of commercial activities. Many of these are support functions that service the bureaucracy. However, most of these functions are not inherent or unique to government. In fact, they can be found in the Yellow Pages in towns all over America. This trend should concern those of us who believe that government should be focused on performing its core functions well and should not be in competition with its own citizens to perform non-core functions. In many areas of government service delivery, state and local governments are literally cutting into the business of business.

In fact, if the experience of other states holds true, then policymakers can reasonably assume that thousands of state employees are engaged in activities that are commercial in nature and could be delivered by private sector firms at a lower cost and higher level of quality. Identifying areas where the private sector can perform government functions more efficiently and at a lower cost can be an important part of the budget solution.

The term "privatization" refers to a broad array of strategies that governments increasingly employ to take advantage of the capabilities of the private sector and thereby provide better value for the public. It covers a spectrum ranging from a simple outsourcing contract—for example, contracting a private landscaping firm to

mow the lawn around public buildings—to sales of government properties and to complex, joint public-private ventures to deliver assets (such as toll roads, bridges, and public buildings) that are government-owned but are financed, built, and operated by the private sector under long-term leases.

Policymakers and government administrators turn to privatization to achieve a number of different goals:

- Cost Savings: A Reason Foundation review of more than 100 privatization studies found that cost savings ranged between 5 and 50 percent, depending upon the scope and type of service; cost savings through privatization typically average between 10 and 25 percent. As perhaps the most impressive example at the statewide level, Florida used privatization competitive sourcing more than 130 times during the eight-year tenure of former Governor Jeb Bush, saving more than \$500 million in actual dollars and preventing an estimated \$1 billion in additional costs (see discussion in next section).
- Access to Expertise: Contracting gives governments access to expertise they do not have inhouse on an as-needed basis. It is cheaper to retain architects, engineers, and lawyers on an as-needed basis than to hire them as full-time employees.
- Better Quality: Competition brings out the best in competitors, whether it is in sports or in the business of providing public services. Bidders have incentives to offer the best possible combination of price and service quality to beat their rivals.
- Improved Risk Management: Contractors, rather than the government, are responsible for cost overruns, strikes, delays, and other risks.
- Innovation: Competition to win and retain contracts spurs the discovery of new, cutting-edge solutions. Without competition, even top-notch employees may stop looking for ways to improve how they meet customers' needs.
- Meeting Peak Demand: The cost of providing a
 public service can be raised considerably by the
 capital and manpower needed to satisfy demand
 at peak periods, even though those peaks may last
 only for a few hours a day, a few days a week, or

- a few months a year. Contracting allows governments to obtain additional help when it is needed so that services are uninterrupted for residents.
- Timeliness: "Time is money" if you are a contractor footing the bill, or if your contract with the city or state includes penalties for delays. Contractors can recruit additional workers or provide performance bonuses to meet or beat deadlines, options that often are unavailable to in-house staff.

All of these goals can be bundled under the banner of "performance." Using privatization to achieve a combination of cost savings, quality, speed, expertise, and innovation achieves higher performance in government service delivery.

Because every state government uses privatization to some degree—and in myriad ways—comprehensive studies of state-level use of privatization are difficult to produce and are rarely compiled. The most recent, comprehensive state-level privatization trend survey, released by the Council of State Governments (CSG) in 2003, found that the amount of privatization largely remained the same or increased slightly across the states between 1998 and 2002. When asked about the primary motivations for privatization, a majority of state budget directors cited cost savings, while agency heads ranked a lack of personnel or expertise as the number one reason for privatization. The CSG survey also noted that privatization trends will likely continue in state agencies, with nearly half of surveyed officials responding that privatization in their state or agency was likely to increase and the other half responding it would remain the same.

While there are literally dozens of state services and government activities for which privatization could be applied, some of the most often-privatized at the state-level include:

- Highway design and maintenance.
- Building repair and maintenance.
- Vehicle fleet operations, maintenance, and ownership.
- · Information technology.

- Administrative support services (e.g., HR, payroll, accounting, mail, printing, etc.).
- Risk management (e.g., claims processing, loss prevention services).
- Facilities financing, operations, and maintenance.
- · Park operations and maintenance.
- Corrections and mental health (facility operations and management; health care, medical and food services).
- Core infrastructure (roads/transit, water, etc.).
- · Engineering services.
- Welfare-to-work programs.
- Child care, child welfare, and adoption programs.
- Juvenile rehabilitation.
- · Environmental lab analysis.

Recommendations for privatization are not self-implementing. Privatization is a disruptive process in that it requires transformational change—a change in thinking among career civil servants and among appointees who are mastering new responsibilities, and people by nature resist change. Change does not occur overnight, and it often happens in fits and starts. States can reasonably expect to see a mix of successes and challenges, and it will take a sustained commitment by policymakers and administrators to ensure that the full benefits will be realized.

The success of any privatization initiative will depend on a variety of factors, but two stand out:

- Performance-based contracts: The legal foundation of a privatization initiative is a contract that spells out all of the responsibilities and performance expectations that the government partner will require of the contractor. No detail is too small. Failure to meet the performance standards specified in the contract should expose the contractor to financial penalties, and in the worst-case scenario, termination of the contract.
- Strong contracting monitoring and oversight:
 Government does not walk away after signing a
 contract; in fact, in many ways, the process—and
 an ongoing partnership with the contractor—is just
 beginning. Policymakers and administrators should

develop strong oversight, monitoring, and assessment protocols before entering into a contract to ensure compliance and performance, and then they should follow through on full implementation. Monitoring should focus on quantifiable measures and achieving results, not on process.

"Identifying areas where the private sector can perform government functions more efficiently and at a lower cost can be an important part of the budget solution."

To help keep state budgets in check and promote efficiency in government, it is critical to eliminate wasteful, non-essential government functions by continually challenging state entities to identify and focus on their core functions and competencies. Privatization and competitive contracting are vital tools in this process that involve looking at everything government agencies do and determining whether private firms could do the same things more efficiently and effectively. Additionally, minimizing government competition with businesses will help states retain (and grow) private sector jobs and increase state revenue by shifting tax-exempt properties and activities to the taxable sector.

Recommendation: Increase the use of privatization and competitive contracting to execute tasks to lower costs and improve the quality of service provided.



- Gilroy, Leonard and Adrian Moore, Ten Principles of Privatization, Legislative Principles Series No.
 7, Heartland Institute, Chicago, IL, July 2010. www.heartland.org/custom/semod_policybot/ pdf/27946.pdf
- Gilroy, Leonard, Streamlining Government through Privatization and Public-Private Partnerships, Testimony before the New Jersey Privatization Task Force, Trenton, NJ, April 7, 2010.

- Savas, E.S., Privatization and Public-Private Partnerships, New York, NY, Chatham House Publishers, 2000.
- Annual Privatization Report 2009, Reason Foundation, www.reason.org/apr2009



• Competitive Contracting of Public Services Act



Establish a State Privatization and Efficiency Council

As discussed in the previous section, policymakers should embrace privatization and the competitive contracting of government services to drive service delivery improvements and better value for each taxpayer dollar spent. A key lesson learned from global experience in privatization is that it works best when governments develop a centralized, independent, decision-making body to manage privatization and government efficiency initiatives.

State policymakers should follow the lead of innovative states like Florida by creating a Council on Efficient Government designed to serve as the enterprise-wide gateway for best business practices in competitive contracting and standardize how the state identifies and conducts competition initiatives (i.e., a state "center of excellence" in procurement).

Florida's Council on Efficient Government was developed in 2004 during former Governor Jeb Bush's tenure and was a key component of a strategy that ultimately helped his administration realize over \$550 million in cost savings through over 130 privatization and competition initiatives. When many other states were raising taxes, these initiatives helped Florida shed almost \$20 billion in taxes during Goveror Bush's tenure.

Midway through his term, some of Governor Bush's major privatization successes became overshadowed by the media spotlight on a few major outsourcing projects that experienced difficulties in implementation. Recognizing the need to improve (a) state procurement and (b) the state's ability to monitor the procurements, Gov. Bush

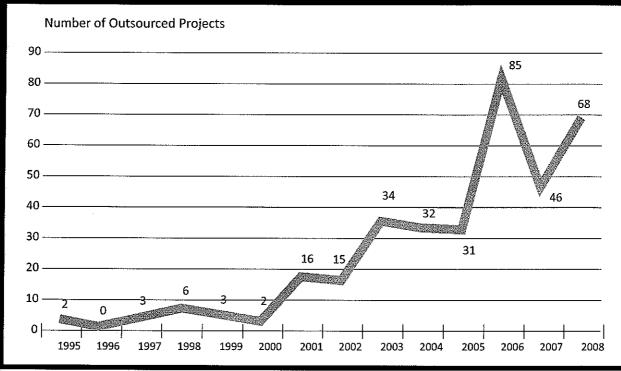
signed an executive order in March 2004 directing the Department of Management Services to create a "center of excellence" authorized to conduct a statewide evaluation of Florida's competitive sourcing efforts. The new Center for Efficient Government (CEG) (subsequently codified by the legislature as the Council on Efficient Government) was empowered to "identify opportunities for additional [competition] initiatives, and oversee execution of future [competition] projects."

The CEG's mission is "to promote fair and transparent best business practices in government in order to foster accountability, competition, efficiency, and innovation in the way state agencies serve Florida's citizens." It serves as the enterprise-wide gateway for best business practices in competitive sourcing and standardizes how the state identifies opportunities, conducts competitions, and awards and manages contracts for government services. Most importantly, the CEG prepares business case evaluations of proposed privatization initiatives before deciding whether or not to proceed in order to help managers and policymakers thoroughly evaluate an initiative's merits from the outset.

"When many other states were raising taxes, these (privatization) initiatives helped Florida shed almost \$20 billion in taxes during Governor Bush's tenure."

Prior to 2001, Florida had a total of 16 outsourced projects reported by state agencies. From 2001 to 2006, the state initiated an average of 37 projects annually (see Figure 2 on the following page). For FY2008, state agencies identified 551 projects currently being outsourced with a lifetime value of over \$8 billion. Notably, the CEG was initially created in 2004, which coincides with the tremendous ramp-up in state privatization. Since Bush's departure, the CEG is still humming along. In 2009 alone, the Council evaluated 23 new business cases for potential agency outsourcing projects with a cumulative value

Figure 2. Florida State Outsourcing Projects by Fiscal Year, 1995–2008



Source: Florida Council on Efficient Government

of more than \$225 million, identifying more than \$31 million in projected savings to the state.

Other states should establish similar centers of excellence that are given the responsibility to:

- Develop a standardized, enterprise-wide process for identifying and implementing competitive sourcing.
- Assist agencies in developing business cases for any proposed privatization initiative—before procurement—that clearly outline the rationale for the initiative (cost savings, service quality improvements, changing antiquated business practices, etc.).
- Develop rules instituting performance-based contracting and business case development as requirements for state procurements.
- Disseminate lessons learned and best practices in competitive sourcing across state government.

- Conduct an annual or biannual inventory of all functions and activities performed by state government, distinguishing between inherently government and commercial activities.
- Create a uniform cost accounting model to facilitate "apples-to-apples" cost comparisons between public and private sector service provision (critical to ensure a level public-private playing field).
- Review and take action on complaints regarding inappropriate government competition with the private sector.

With widespread state fiscal crises deepening across the country, other state policymakers will increasingly look to the example set by Florida and the other states that have pioneered this privatization "center of excellence" concept as they struggle to close large budget deficits. For example, in December 2009 Louisiana's Commis-

sion on Streamlining Government (established by Gov. Bobby Jindal) released a set of 238 government downsizing recommendations—including a recommendation for a "center of excellence" in privatization, as well as over a dozen specific privatization proposals—that were estimated to save over \$1 billion.

Similarly, the New Jersey Privatization Task Force-created by Gov. Chris Christie under an early executive order-released a report in July 2010 identifying 40 specific privatization opportunities across state government, with an estimated annual savings of over \$200 million. Notably, the New Jersey Privatization Task Force also recommended that finding efficiency through private sector competition should become standard policy for all state agencies. One of the key recommendations for doing so involves the establishment of a centralized privatization entity for the state that would fulfill functions similar to Florida's Council on Efficient Government.

Having a Florida-style "center of excellence" in place would facilitate the regular, wholesale review of state government activities with an eye toward right-sizing government through competition and privatization. But at the same time, it recognizes that successful privatization requires a high standard of due diligence in contracting. Hence the proposed council would establish a standardized method for procuring and managing contracts in order to maximize accountability, transparency, competition, and to deliver the best value for taxpayers.

A sound privatization policy framework is essential to maximizing cost savings and value for money in the delivery of state services. Experience from Florida, Virginia. and Utah-who have each implemented versions of the procurement "center of excellence" concept—also suggests that this approach has increased the public's confidence and has mitigated perceptions of impropriety, a common public perception concern with any privatization initiative. Further, having a dedicated unit manage the process on an enterprise-wide scale ensures that the benefits of lessons learned and best practices are shared among agencies.

Recommendation: Pass legislation creating a Florida-style "center of excellence" on privatization and competitive contracting.



Additional Resources:

- · Gilroy, Leonard and Adrian Moore, Ten Principles of Privatization, Legislative Principles Series No. 7, Heartland Institute, Chicago, IL, July 2010. www.heartland.org/custom/semod_policybot/ pdf/27946.pdf
- Gilroy, Leonard, State Competitive Government Commission: A Tool for 'Right-Sizing' Kansas Government, Reason Foundation testimony to the Kansas House Appropriations Committee, Topeka, KS, January 27, 2010. http://reason.org/news/ show/state-competitive-government-c
- · Garrigo, Henry, "Look Before You Leap Into Privatization: Florida's Council on Efficient Government Sets a New Standard in Transparency, Due Diligence in Privatization and Contracting Decisions," Innovators in Action 2009, Reason Foundation, Washington, D.C., January 2010. http://reason. org/news/show/innovators-in-action-2009
- Florida Council on Efficient Government. Annual Report 2009, Tallahassee, FL, 2009. dms.myflorida.com/index.php/content/ download/63973/274570/version/1/file/ Annual+Report+2009.pdf



ALEC Model Legislation:

Council on Efficient Government Act



Create a Statewide Real Property Inventory and Search the Balance Sheet for Asset Sale and Lease Opportunities

How much land do states own and how many assets do they hold in the public trust? These seem like basic questions that would have simple answers, but many states and counties do not have the kind of basic property and asset data that a well-run business or responsible family rely on to manage its finances. With millions of acres and thousands of assets in government portfolios, officials should take steps to identify what they own, determine whether government or private ownership is the most effective, and streamline the efficient disposal of all unneeded real property.

A Real Property Inventory (RPI) is simply a written record of what land and assets a government owns. Real property assets are typically immovable property, such as office buildings, warehouses, heavy equipment, or bridges. Governments can also track additional property, like vehicles, in a comprehensive inventory. Inventories can be built in many different ways, but whatever the shape an RPI takes, the end product should be able to answer five questions:

- What does the state own?
- Where is it located?
- What is the condition of what the state owns?
- What is the value of what the state owns?
- What is the best use of what the state owns?

Real Property Inventories have a wide range of application and value. The process of developing and maintaining an inventory allows government officials to assess their costs in managing property to find ways of being more efficient with taxpayer money. Inventories can even help monitor the effectiveness of spending projects and provide data to economic crisis early warning systems. There are additional non-financial benefits, such as legal compliance and mapping systems for emergency response units. Finally, a comprehensive list of land and assets, up-to-date with their current use, allows a governing entity to assess what property it might be able to lease or divest to generate upfront cash in times of economic crisis.

The two most common and effective ways of extracting value from government assets are asset divestiture (the outright sale of government land or assets) and asset leases (long-term leases of public assets to private sector investor-operators). Government asset sales and leases can take a variety of forms. In some cases, government entities self real property outright, in either an "as is" or "entitled" state (having secured necessary zoning approval). In other cases, these transactions are established as a long-term lease agreement or concession, particu-

larly for revenue-generating enterprises like a golf course, toll road, or parking facility. In still other cases, such as government-owned buildings, approaches include sale-leasebacks, where the private sector purchases the property for a fixed price and agrees to lease back the facility to the government entity for an agreed upon period of time. Importantly, the government entity can receive a lump-sum cash payment in all three scenarios.

A thorough, centralized inventory of all state-owned real property and assets is a critical first step that will form the basis for planning, maintenance, and operational decisions moving forward. Developing such a database will also permit the accumulation of benchmarking data to facilitate decision-making while implementing property management decisions. It will also provide documented institutional memory in the face of changes in personnel.

"An important first step for states should be to conduct an 'inventory of inventories' to find out what the state already knows it owns."

An important first step for states should be to conduct an "inventory of inventories" to find out what the state already knows it owns. This survey project would involve coordinating various state agencies and creating common metrics to record ownership data to provide a benchmark for what the next steps in the inventory process should be.

Afterwards, the governor should commission a review to categorize all state-owned property and move toward asset divestiture and realignment opportunities. Within existing staff, a position should be identified within the state's general services agency (or similar department) to be directly accountable for overseeing this portfolio, and given the necessary authority to exercise those duties on an ongoing basis. Ongoing support for asset

inventory maintenance is key, as the state will benefit most from a dynamic database that it can add to and subtract property data from over time.

Upon completion of the asset inventory, the governor should commission a review to categorize all state-owned property as: (1) property currently serving a critical function (state courthouses and public safety facilities would be examples) and thus unlikely for sale or divestiture; (2) real estate that is unused, underutilized, or not linked to concrete program goals; (3) revenue-generating assets that offer significant lease opportunities; or (4) non-critical assets that are not supporting an inherently governmental function (such as public golf courses) for which both sale or lease are viable options.

After the commission categorizes all state-owned property, the following steps should be taken:

- Assemble a procurement team to prioritize asset lease opportunities. This team—appointed by the governor and composed of budget, policy, financial, and legal experts—would conduct a rigorous assessment of potential asset lease opportunities and identify a recommended set of top-tier assets to advance toward privatization or public-private partnerships.
- Incentivize quick identification and disposal. State officials should develop a system to disburse some portion of the proceeds from real property and asset sales to programs and departments, providing an incentive for those departments to participate in the divesture process. Agencies that identify assets for divestiture should benefit from those sales. For example, the department that operated the surplus property (parks, etc.) should be given a "commission" for helping identify unneeded property—perhaps 10 percent of proceeds—which could be used for needed capital upgrades or other purposes. As it stands, departments have few incentives to seek divestiture opportunities because they receive none of the benefits of surplus sales.
- Contract with the private sector to conduct a market-value disposal of surplus property. Such

opportunities include partnering with local private real estate brokers. Additionally, rather than conducting its own live auctions, the state can employ readily available online auction markets for the disposal of property. Whereas live auctions require a physical presence and severely limit participation, online auctions are global in their reach and participation.

The recent experiences of state and local governments demonstrates the opportunities and potential of asset divestiture initiatives. For example, using technology and analysis systems developed by the vendor ARCHIBUS to manage state property, the state of Missouri saved \$3 million directly through the consolidation of state facilities and an additional \$10 million in annual savings from improved billing, space utilization, work order, and lease management.

Georgia offers another powerful example of this process's success. In 2004, Georgia Governor Sonny Perdue realized each state agency was handling its own space management without cross-agency coordination, resulting in inefficient facility use and little or no opportunity for comprehensive management of real estate assets. He created the "Governor's Commission for a New Georgia" by executive order, one aspect of which was to develop a statewide land inventory.

When the state set out to inventory its property it found many cases of gross mismanagement of public resources. Using its state "Building, Land & Lease Inventory of Property" (BLLIP), Georgia identified several properties that were not being put to their full use. In one case, underused properties were consolidated into the Douglasville One Stop Shop, a collocation project of three state agencies. This project resulted in:

- A cost savings totaling \$150,000 annually (maintenance, security, etc.).
- An additional 18,000 square feet of office space.
- \$22 million revenue to the state by selling surplus property (easily identifiable through BLLIP).

 \$1.1 million saved in 2006 through renegotiation and consolidation of leases that will save an estimated \$20.5 million through 2012.

BLLIP also identified two properties in close proximity of each other that could be consolidated, saving Georgia \$102 million in a 10-year time frame. The fiscal benefits Georgia attained did not come from passive management but intentional pursuit of efficiency. Other states would similarly benefit from taking comprehensive steps towards being a better steward of the land they own and streamlining the efficient transfer of all unnecessary or under-used real property. This would improve proper asset management, encourage economic growth, and generate—instead of consuming—tax dollars.

Recommendation: States should prepare comprehensive asset inventories—updated continually on an ongoing basis to ensure currency and accuracy—and commission a review to categorize all state-owned property and identify asset divestiture and realignment opportunities.



Additional Resources:

- Randazzo, Anthony and John Palatiello, Knowing What You Own: An Efficient Government How-To Guide for Managing State and Local Property Inventories, Policy Study 383, Reason Foundation, Washington, D.C., June 2010. http://reason.org/files/ how_to_manage_or_sell_state_local_property.pdf
- Palatiello, John, What's in the Government's
 Attic?, Policy Brief 33, Reason Foundation, Washington, D.C., December 2004. http://reason.org/news/show/whats-in-the-governments-attic



Achieve Savings through Employee Incentive Programs

Private businesses often develop innovative compensation tools to help retain quality workers and reward them for coming up with cost-saving ideas. Meanwhile, government agencies consistently struggle to offer performance incentives that match those available in the private sector—programs that increase morale, reward

high performance, and help reduce the cost of running state government. Budget constraints, fractured, shortterm planning, and strict civil service laws form a barrier to incentive programs that can improve worker performance and boost flagging morale.

Policymakers should generate personal ownership of savings for public employees by allowing them to be rewarded for the savings generated by innovation. While this program may not be feasible for all government agencies, those that effectively implement the program can achieve significant cost savings, improve service, and reward workers for creative thinking.

"Minimizing government competition with businesses will help states retain (and grow) private sector jobs and increase state revenue by shifting tax-exempt properties and activities to the taxable sector."

For example, Baltimore County, Maryland, implemented an innovative "gain-sharing" program that encourages frontline employees to recommend and implement projects that reduce cost and improve customer service. Half of any savings that result are distributed to the employees who implemented the proposal and the other half is returned to the general fund. In one example, employees in the Dietary Division of the Bureau of Corrections found ways to streamline and improve the meal preparation system, saving the county more than \$150,000. As a result, the 13 employees that designed and carried out the changes received one-time checks for more than \$5,000 each.

Recommendation: Develop a program (or programs) for state employees to allow them to be rewarded for savings generated by new innovations or re-engineering of existing business practices.



he need to reform state budgeting is more vital then ever before. As federal stimulus funds recede, states will grapple with even larger budgeting gaps. Clearly, the "business-as-usual" budgeting approach of raiding nongeneral fund accounts and using tricky accounting techniques will no longer rescue states from a budget crisis. States need innovative budgeting strategies to address these new economic challenges—without resorting to economically damaging tax increases.

"State and local governments depend entirely on the private sector for their resources and cannot continually outpace the wealth-creating sector of the economy." Though daunting, state budget problems can be diligently addressed by using these budget tools so lawmakers are not unduly influenced by emotional pleas for continuing funding based on unsustainable spending decisions of past years. If lawmakers ultimately ask state citizens to pay higher taxes for additional spending, the public will know one of two things: Either, lawmakers believe the state's lowest priorities are still worth purchasing even in this tough economic climate and taxpayers need to sacrifice more; or taxpayers will know the budget is not properly prioritized and lower priorities are being purchased first, resulting in the request for tax increases to fund higher priorities.

Despite the economic difficulties facing the states, there is a pathway to budget reform. By following the policies suggested in this ALEC Budget Reform Toolkit, lawmakers can make informed decisions and build a solid budget focused on delivering the best results for taxpayers and users of government services.



How to access ALEC model legislation:

ALEC members can login to www.alec.org to view all ALEC model legislation. Non-members can request a copy of ALEC model legislation by contacting Jonathan Williams, director of the Tax and Fiscal Policy Task Force at: (202) 742-8533 or jwilliams@alec.org



INDEX of Recommendations

Tools to Modernize State Budgeting

- Recommendation: All existing programs should fit within one of the state's core functions or they should be abolished. Measurable outcomes for each core function should be identified and agency activities prioritized.
- Recommendation: State policymakers should close the current gap in their budgeting process by adopting provisions similar to Texas. Giving the state's chief financial officer the ability to prevent unrealistic budgets from being adopted until the budgets match expected revenues would be an important step at tightening and strengthening fiscal control systems to keep the price of government in check.
- Recommendation: Pass a balanced budget requirement, mandating that the expenditures included in the budget for the next fiscal year shall not exceed estimated revenues, and create a protected emergency reserve account.
- Recommendation: States should adopt a constitutional revenue or spending limit. Such a limit would impose much needed discipline on profligate spending patterns.
- Recommendation: The legislature should require each agency to have a mission statement with goals and objectives linked to the state's core functions of government.
- **Recommendation**: After requiring that all agencies create a traceable monitor of their performance, a separate process should be instituted at the enterprise level to regularly assess their performance.

- Recommendation: States should adopt a Budgeting for Outcomes (BFO) approach to bring sanity and fiscal sustainability to the state budget process. BFO integrates strategic planning, zero-based budgeting, and performance-based budgeting into a workable, common-sense system that has been replicated in numerous state and local governments. State policymakers would be well-advised to begin implementing a similar transformation in their budgeting process to ensure that taxpayer dollars are spent with maximum effectiveness and that the trade-offs among different categories of spending—especially in a budget crisis—are made clear and explicit.
- **Recommendation:** Adopt a item-reduction veto policy.

Tools to to Improve Budget Transparency

- Recommendation: States should develop searchable online budget transparency tools for state and local budgets.
- Recommendation: Legislators should adopt a 72-hour timeout period for all future budget and tax bills.
- **Recommendation:** Require completed fiscal notes before bills can be acted on.

INDEX of Recommendations

Tools to Control Cost and Improve Government Efficiency

- **Recommendation:** Adopt a state hiring freeze encompassing all departments.
- Recommendation: Everything should be on the table, including changes in benefits and increased employee contribution rates, as well as employer contribution rates. Most importantly, states should consider replacing their defined-benefit plans with defined-contribution (401k style) plans for new employees.
- Recommendation: Freeze defined-benefit OPEB plans, and replace them with defined-contribution plans for new employees. One approach is to offer optional participation in Health Savings Accounts (HSA) for state workers. Indiana's experience has been highly successful, with 70 percent of state workers choosing the HSA plans—with Indiana's taxpayers saving millions in the process.
- **Recommendation**: Create a tracking system whereby any position that is vacant for more than six months is eliminated.
- Recommendation: Policymakers should delay automatic pay increases for state employees until the rising costs of government are brought under control.
- **Recommendation**: Lawmakers can improve the performance of state agencies by implementing activity-based costing.

- **Recommendation**: States should create a permanent sunset review commission to recommend ways the state can cut costs, reduce waste, and improve efficiency and service levels.
- **Recommendation**: The state auditor (or similar position) should be given the authority to conduct regular, comprehensive performance audits of state agencies.
- **Recommendation**: States should give authority to independent firms to conduct regular, comprehensive recovery audits of state agencies.
- Recommendation: Increase the use of privatization and competitive contracting to execute tasks to lower costs and improve the quality of service provided.
- **Recommendation:** Pass legislation creating a Florida-style "center of excellence" on privatization and competitive contracting.
- Recommendation: States should prepare comprehensive asset inventories—updated continually on an ongoing basis to ensure currency and accuracy—and commission a review to categorize all state-owned property and identify asset divestiture and realignment opportunities.
- **Recommendation:** Develop a program (or programs) for state employees to allow them to be rewarded for savings generated by new innovations or re-engineering of existing business practices.



- Balanced Budget Certification Act
- Independent Revenue Forecasting Act
- Tax and Expenditure Limitation Act
- · Council on Efficient Government Act
- An Act Relating to Performance Audits of Governmental Entities
- Item-Reduction Veto Constitutional Amendment
- Taxpayer Transparency Act
- Public School Financial Transparency Act
- The 72-Hour Budget Review Act
- Fiscal Note Act
- Commission on Economy and Productivity in State Government Act
- Legislative Budget Audit Commission Act

- An Act Relating To Recovery Audits For Government Overpayments Of Tax Dollars
- Competitive Contracting of Public Services Act
- Council on Efficient Government Act
- ALEC's Statement of Principles on State and Local Government Pension and Other Post Employment Benefit (OPEB) Plans
- Transparency and Government Accountability Act

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